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China can decrease leverage by levying real estate tax

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IN recent years, the high nongovernmental debts in China, i.e., high debts of enterprises and residents with an increasing leverage, have received extensive attention at home and abroad. High debts are very risky for every single company and household and for the country. High debts may trigger a financial crisis when the expenditures for the loans come to surpass the returns.

Writer: Schulzick of the Free University Berlin and Alan Taylor of the University of California Davis found that "credit growth is a powerful predictor of financial crises" from a database of 14 high-income countries in 2010. How to solve the problems of high debts and decrease leverage is a pressing matter now.

Elementary arithmetic teaches us that external debts can be benign for the country when (1) the involved companies are expanding and can make productive use of the loans, and (2) when the earnings of the application of the loaned capital surpasses the costs of the loan, i.e., when the interest rate of the loan is below the rate of return of the chosen applications — and remains so at least as long as the redemption will take. It is indisputable that leverage can work in two directions. It can increase earnings and make better running companies and better private life, and it can work in the opposite direction, ruin companies and make private life miserable.

The high debt ratio of Chinese households and real estate companies is related to real estate bubbles. If a real estate bubble is not eliminated, it is difficult to reduce the high debt ratio and eliminate the financial risk. Real estate and bank credit are naturally linked. Banks provide funds for both the supply and demand sides of real estate. That has created a high leverage in the real estate industry. Without adjustment in housing prices, deleveraging is difficult to sustain.

What measures are conducive to reducing housing prices? We recommend the implementation of real estate tax. It is actually helpful to reduce the pro-cyclicality of the financial cycle, i.e., to reduce the amplitude of financial variables' fluctuations during the credit cycle of the expansion and contraction of access to credit over time. If we have a real estate tax and no land-transfer fees, in fact, we rely less on fiscal and more on finance, which is conducive to reducing the pro-cyclicality of finance. Lowering the actual housing prices (i.e., to pay once, namely when acquiring a flat) by introducing a new permanent but affordable burden (by an annually continuing real estate tax) is the key to deleveraging.

First, we need to deal with the relationship between real estate tax and land-transfer fees. Land in China is divided into collective land and State-owned land. State-owned land is owned by the State. Land auctions do not grant land ownership, but land use rights for

a certain number of years (mostly 70 years). The important motivation for the Chinese Government, especially local governments, to develop real estate comes from China's tax system.

Second, in the total value of real estate, the value of the house itself is small. The actual building cost in China is quite low. By 2014, China's Engineering Cost Network showed that the cost of multi-story housing per square meter was 1,362 yuan, and that of high-rise housing was 1,817 yuan per square meter, or US\$26 per square foot, which is surprisingly low compared with the U.S. standard. The key to implementing real estate tax is separating the value (and price and ownership) of the land and of the "bricks."

Third, a good real estate tax system should balance the interests of all parties, including government, banks, developers and residents. A good tax policy design is the key to continuous operation of real estate tax. This tax rate must ensure that the government receives the same amount of revenue as the previous land auctions so as to have the initiative to levy. In order to stabilize housing prices, the government must impose a relatively high real estate tax. If the real estate tax is set too low, it will not play a role in regulating housing prices.

Good real estate tax measures are conducive to supply-side reform of the real estate market and the establishment of a long-term mechanism for price control in the real estate market. The role of real estate tax on the market should be long-term and sustainable. It can adjust the housing needs of different income groups quantitatively, so as to adjust supply and demand rationally. At the same time, it increases the revenue of local governments, which makes local governments more active in levying taxes. When there is no land to sell, local governments also have tax revenue to provide better public goods and services.

Fourth, as an important substantive element of real estate tax, the system of reduction and exemption is the key to the sustainable and sound operation of real estate tax. Real estate tax should be levied on the valuation of real estate. We should differentiate on whether the land-transfer fees have been paid or not. The real estate with the land-transfer fee already paid should be exempt from the real estate tax within 70 years. A value-added tax should be considered, that is, the added value from the sale of real estate should be taxed.

If the price paid by the residents to purchase the house already includes the land-transfer fee, it is obviously unfair to use this price as the basis for the annual payment of real estate tax. Therefore, a reasonable choice could be converting the land-transfer fee that has been paid into annual payments and then assessing the real estate value, or deducting it from the real estate appraisal value in a certain proportion.

(Dr. Yu Changgu is a lecturer at the School of Finance, Nankai University, Tianjin. Dr. Bernhard Börs-Beyersiek is professor of Real Estate University, Germany.)

Monday April 8, 2019

Keeping our tradition in a safe, green way

Lin Min

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PAYING respect to our deceased loved ones during the Qingming Festival, or Tomb-sweeping Day, is a time-honored tradition that shows the traditional reverence for ancestors in Chinese culture. Observed for more than 2,500 years, the festival has shown no sign of waning. Around April 5 every year, millions of people travel a long way to visit the tombs of their deceased loved ones, while others worship their ancestors at home.

However, as urbanization has brought tremendous changes to the way people live and work, the way of observing the festival and other occasions deserves reconsideration by the whole nation.

During the festival and other worshipping occasions, people burn joss sticks and joss paper as an essential part of the traditional rituals, in addition to preparing lavish foods. It is the burning of joss sticks and joss paper offerings that are now presenting big problems.

The burning of such offerings not only produces air pollutants, but also may cause fires. Hill fires have been reported in recent years in the Chaoshan area of eastern Guangdong, where probably the most meticulous rituals in China are practiced.

The modern city of Shenzhen is not immune to such hazards. On Friday, a fire broke out in an apartment in a housing estate in Putian District, as the family was burning paper offerings for a

Qingming Festival ritual. Fortunately no casualties were reported after firefighters quickly put out the fire, rescued four people trapped inside the house and evacuated dozens of neighbors.

People in urban areas now mostly live in apartment buildings, vastly different from the independent houses or less-crowded compounds people used to live in for thousands of years. Burning paper offerings inside apartment buildings creates huge fire hazards, in addition to polluting the air, and thus is no longer suitable for urban dwellers.

Shenzhen is home to a large number of Chaoshan people, who are known to practice rigid worshipping traditions. People from some other regions, like Fujian, also stick to such traditions. It is time for news media to initiate discussions on whether we should keep the tradition of burning paper offerings, and people should come to the realization that any tradition needs to be tweaked if it causes problems in today's society. Firecrackers have been banned in most cities even though they remained a Spring Festival tradition for thousands of years.

In 2017, Baishan City in Gansu Province banned the burning of paper offerings on roadsides and near schools, hospitals and government buildings. Some other cities, like Dalian in Liaoning and Tongling in Anhui, have imposed similar restrictions. Shenzhen should also consider new regulations aimed at reducing fire hazards associated with worshipping rituals. (The author is head of the Shenzhen Daily News Desk.)

An alluring prospect of Shenzhen-Hong Kong innovation cluster

Miss Bo-Good

THIS rapid rise in Chinese use of the international patent system shows that innovators there are increasingly looking outward, seeking to spread their original ideas into new markets as the Chinese economy continues its rapid transformation, said WIPO (World Intellectual Property Organization) Director General Francis Gurry.

Two Shenzhen technology companies, Huawei Technologies and ZTE, were the top filers of international patent applications in 2017, followed by Intel and Mitsubishi, according to WIPO. Huawei, with a record number of 5,409 published PCT applications, remained the top corporate filer in 2018, while ZTE took the fifth spot.

These rankings mean more than meets the eye regarding Shenzhen's achievements in innovation and innovative dynamics. In GII (Global Innovation Index) 2018, which was published in September 2018, the Shenzhen-Hong Kong innovation cluster was ranked second among the top-100 science and technology clusters in the world, following Tokyo-Yokohama. GII 2018 was conducted by WIPO, too. When assessing the worldwide science and technology cluster, WIPO's economist added the scientific articles and patents filed via PCT to evaluate global innovation clusters, including Tokyo-Yokohama, Shenzhen-Hong Kong, San Jose-San Francisco, Beijing and other innovation clusters. WIPO used an algorithm to sort these data and map the techniques.

Through this, Shenzhen-Hong Kong cluster came out the second in terms of the intensity of innovation-related activities.

As everyone knows, ZTE was suffering the hardship of scrutiny from the U.S. in 2018. From my point of view, the innovative outcome of this company will be under great influence. However, it did not produce a negative impact on the GII 2018 ranking of the Shenzhen-Hong Kong innovation cluster. The prospect of the Shenzhen-Hong Kong innovation cluster may be more alluring than we think. And the ranking in the upcoming GII may be of great promise.

Another big positive is that the Chinese Government is doing a lot to nurture innovation in the Guangdong-Hong Kong-Macao Greater Bay Area. The Greater Bay Area's outlined development plan gives great opportunities many other regions can only dream of. China's Greater Bay Area, which features different social systems, tax systems and customs, bears some resemblance to the EU, which attains great achievements through the Horizon 2020 policy to boost the innovation. Shenzhen and Hong Kong enjoy great support from the State, but they must work hard for all the rewards they want and deserve.

(With previous work experience in the United States, the author now works in Shenzhen and has studied the innovation policies for some time.)

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